

Internal Revenue Service
memorandum

CC:TL-N-1646-92
FS:IT&A:TCOswald

date: DEC 31 1991

to: District Counsel, [REDACTED]
Attn: [REDACTED]

from: Assistant Chief Counsel (Field Service) CC:FS

subject: Informational reporting requirements for [REDACTED]
companies servicing [REDACTED] and [REDACTED] sponsors

This is in response to your November 8, 1991, request for Field Service Advice.

ISSUES

1. Whether [REDACTED] ("[REDACTED]"), which services [REDACTED] and [REDACTED] number sponsors, is subject to the information reporting requirements of I.R.C. § 6041 for payments made to such sponsors.
2. Whether [REDACTED], which services [REDACTED] and [REDACTED] number sponsors, is subject to the information reporting requirements of I.R.C. § 6045 for payments made to such sponsors.
3. Whether certain penalties may be imposed against [REDACTED] for failure to comply with the information reporting requirements of I.R.C. §§ 6041 or 6045.

CONCLUSIONS

1. Since the payments to sponsors are gross income of a fixed and determinable amount within the meaning of section 6041(a) and Treas. Reg. § 1.6041-1(c), [REDACTED] is required to file information returns with the Internal Revenue Service ("Service") for payments to noncorporate sponsors which equal or exceed \$600 for any particular taxable year. See, Treas. Reg. § 1.6041-3(c).
2. Section 6045 requires the filing of information returns only by those brokers, when required by the Secretary, in accordance such regulations as the Secretary may prescribe. There are currently no regulations under section 6045 which require [REDACTED] companies to file information returns with the Service concerning payments to sponsors. Thus, section 6045 does not require [REDACTED] to provide information returns to the Service concerning payments to such sponsors. Additionally, we do not believe that [REDACTED] fits the definition of "broker" under the statute.

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3. The imposition of civil penalties under sections 6721 through 6724 depends on whether [REDACTED] can establish that its failure to file was due to reasonable cause and not due to willful neglect. Because the facts are not sufficiently developed, we cannot provide definite advice at this time. Should you require supplemental advice, we would be pleased to reconsider this issue upon your request when sufficient facts have been adduced. Moreover, with respect to the imposition of criminal penalties, we believe that any comment at this time would be very premature.

FACTS

The bare facts as related to us in the undated memorandum from ARC ([REDACTED]) Examination as forwarded by your memorandum of November 8, 1991, but received November 19, 1991, are as follows.

[REDACTED] has never filed any of the information returns with the Service which are required under sections 6041 or 6045 concerning the payments to the sponsors. You have informed us that both [REDACTED] and [REDACTED] currently provide the Service with this information concerning the sponsors which they service. You have also informed us that [REDACTED] has been informally advised by a revenue agent that it should be filing information returns with the Service concerning these payments. In addition, there is no case currently docketed concerning [REDACTED]. The information is apparently sought in connection with the possible audit of the sponsors, rather than an audit directly involving [REDACTED].

DISCUSSION

Issue 1. Information Reporting Requirements under I.R.C. § 6041.

Section 6041(a) provides that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than certain payments not here relevant) of \$600 or more in any taxable year must render a true and accurate return under regulations prescribed by the Secretary setting forth the amount of such gains, profits, and income, and the name and address of the recipient of the payment. Under Treas. Reg. § 1.6041-

1(a)(2), the return required by section 6041(a) must be made on Forms 1096 and 1099. Form 1099 is used to report payments concerning each individual payee, and Form 1096 is used to transmit the Form 1099s to the Service.

Treas. Reg. § 1.6041-1(c) states that income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. Treas. Reg. § 1.6041-3(c) exempts from the reporting requirements payments made to corporations, unless the payments are made to corporations which provide medical and health care services, other than payments to a hospital or extended health care facility operated as an exempt organization, under section 501, or operated by the United States or other governmental entity.

██████████ is engaged in a trade or business and makes payments to the sponsors in the course of its trade or business of fixed or determinable amounts of income. Therefore, ██████████ is required by statute and regulations to file information returns with the Service concerning payments of \$600 or more in any calendar year to any sponsor which is not a corporation.

While "income", as used in section 6041(a), is not defined in either the statute or accompanying regulations, the appearance of the word "income" in the phrase "gains, profits and income" strongly suggests that income for purposes of section 6041(a), means gross income. Section 61 defines gross income as "all income from whatever source derived, including but not limited to . . . gross income derived from business". I.R.C. § 61(a)(2); see, Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955).

Since the payments to the sponsors are based upon a percentage of each ██████████, less uncollectible amounts and certain other adjustments, there is a sufficient basis of calculation to render the payments fixed or determinable, thus satisfying this requirement. Treas. Reg. § 1.6041-1(c). Although the amount of payment may be increased or decreased because of the happening of certain events, i.e. the number of ██████████, the schedule of payments remain fixed and determinable. See, Id.

On the question of "fixed or determinable", G.C.M. 38046, I-477-78 (Aug. 13, 1979), considered the question of whether a person engaged in a trade or business, who purchases property in the course of such business from an individual, is required to file a Form 1099 to report any payments made. G.C.M. 38046 concluded that the purchaser is not required to file a Form 1099 because the amount of income paid will depend on the seller's basis in the property. This amount may be unknown to the purchaser, and will not be "fixed and determinable" for purposes of section 6041(a). Thus, where the amount of the income paid

depends on the individual recipient's investment or basis in the transaction and the payor lacks such knowledge, the amount of income paid will not be fixed and determinable within the meaning of section 6041(a) and Treas. Reg. § 1.6041-1(c).

The conclusion in G.C.M. 38046 was based on a careful analysis of the statutory language of section 6041(a), its legislative history, and pertinent court cases, rather than the particular nature of the transaction, i.e., the sale of property. For this reason we think that the inability of the person in business, making a payment of \$600 or more in the course of that business, to determine the actual amount of gross income paid, is an appropriate rationale for not requiring the filing of an information return in certain other transactions. See, Form 1099-Misc, G.C.M. 38240, I-14-79 (January 9, 1980).

We believe, however, that a distinction must be drawn between the basis situation in G.C.M. 38046 in which the payor cannot determine the actual amount of gross income to the recipient and the instant case. The total payment from [REDACTED] to any sponsor is included in the sponsor's gross income. Expenses would later be deducted from that gross income. Thus, the problem in G.C.M. 38046 of the payor not being able to ascertain the amount of gross income is not present here.

Rev. Rul. 65-129, 1965-1 C.B. 519, modified by, Rev. Rul. 67-197, 1967-1 C.B. 319 involved a situation similar to the instant case. The rulings considered the issue of how to report royalty payments made by publishers to authors through the author's literary agents. The rulings held that, where a publisher pays royalties, aggregating \$600 or more to a literary agent on behalf of the author, and the agent later pays the same to the author less certain fees, the agent must report under section 6041 the gross amount of such royalties paid to the author. The agents in that scenario and [REDACTED] here both act in a similar capacity as collection agents. It follows therefore that if the agents were required to file information returns under section 6041, [REDACTED] should also be required to file the same. Although there is a factual distinction because royalties were collected in the agents case, the analogy is nevertheless applicable in this situation.

Finally, giving effect to the broad purpose of section 6041(a), [REDACTED] should file information returns concerning payments to sponsors.

It is indisputable that section 6041 is intended to help the government locate and check upon recipients of income and the amounts they receive. See, United States v. Carol, 345 U.S. 457 (1953); S. Rep. No. 103, 65th Cong. 1st Sess. 20 (1917).

United States v. Haimowitz, 404 F.2d 38, 40 (2d Cir. 1968).

Additionally, section 147(a) of the Internal Revenue Code of 1939, the predecessor of section 6041(a) of the 1954 Code, which exists in its current form substantially unchanged, provided that a return of information is required to be filed by "all persons, in whatever capacity acting" making prescribed payments of \$600 or more to another person in any taxable year. (Emphasis added). This provision was stricken by the House Ways and Means Committee from the draft of H.R. 8300 (Internal Revenue Code 1954), H. Rept. No. 1337, 83rd Cong., 2d Sess., p. 104. Congressional intent to incorporate the full meaning of section 147(a) of the 1939 Code into section 6041(a), except as the former section applied to individuals, can be surmised from the Senate Finance Committee report, S. Rept. No. 1622, 83rd Cong., 2d Sess., p. 141, in its general discussion which states:

Your committee restored the provisions of existing law requiring information returns on certain payments to others of \$600 or more a year. However, under your committee's bill these returns are to be required only with respect to payments made by business (either individual or corporate). (Emphasis added).

In [REDACTED], G.C.M. 32887, I-1251 (July 29, 1964) it was stated:

[T]he underlying purpose of section 6041, insofar as payments made in the course of a trade or business are concerned, is the same as that of section 147(a) of the 1939 Code and corresponding provisions of prior Revenue Acts. Under section 147(a) "all persons, in whatever capacity acting", if otherwise subject to the requirements of the section, were required to file information returns.

It has long been recognized that the purpose behind the requirement of information returns is to provide information relative to the recipient (owner) of income in order that a check might be made against that party's income tax return to see if he has properly accounted for such income. Accordingly, in a situation where there was a question as to which of several eligible parties should file, the party actually making payment was held (with the capacity in which that payor was acting being considered irrelevant to the determination) to be required to file an information return. I.T. 1703, II-1 C.B. 182

In our opinion, the payments to sponsors are gross income of a fixed and determinable amount within the meaning of section 6041(a) and Treas Reg. § 1.6041-1(c). Further, since there is no other practical way to verify the sponsors' gross income received from [REDACTED], the purpose of section 6041(a) would be fully served by requiring [REDACTED] to file information returns.

_____ should file Forms 1096 and 1099 for payments to non-corporate sponsors which equal or exceed \$600 for any particular taxable year. See, I.R.C. § 1.6041-3(c).

Issue 2. Information Reporting Requirements Under I.R.C. § 6045.

You have asked for our opinion whether _____ is a "middleman" subject to the reporting requirements of section 6045. Section 6045 does not require _____ to provide the Service with information returns for payments to sponsors. Section 6045 states, in pertinent part:

(a) General Rule - Every person doing business as a broker shall, when required by the Secretary, make a return, in accordance with such regulations as the Secretary may prescribe, showing the name and address of each customer, with such details regarding gross proceeds and such other information as the Secretary may by forms or regulations require with respect to such business.

* * *

(c) Definitions - For purposes of this section -

(1) Broker - The term "broker" includes -

(A) a dealer,

(B) a barter exchange, and

(C) any other person who (for a consideration) regularly acts as a middleman with respect to property or services.

A person shall not be treated as a broker with respect to activities consisting of managing a farm on behalf of another person.

* * *

Treas. Reg. § 1.6045-1(a)(1) defines the term "broker" as a person that in the ordinary course of business during the calendar year stands ready to effect sales to be made by others. Treas. Reg. § 1.6045-1(a)(9) defines the term sale as "any disposition of securities, commodities, regulated futures contracts for cash, and includes redemptions of stock, retirements of indebtedness and entering into short sales." Treas. Reg. § 1.6045-1(c)(1) and (2) require brokers, except as otherwise provided, to make a return of information with respect to each sale by a customer of the broker.

Additionally, Temp. Treas. Reg. § 5f.6045-1 currently applies to returns of information of brokers and barter exchanges and excludes from reporting sales to certain exempt recipients. Treas. Reg. § 1.6045-2 requires brokers, as defined in Treas. Reg. § 1.6045-1(a)(1), to furnish statements with respect to certain substitute payments involving short sales. Treas. Reg. § 1.6045-3T applies to information reporting for real estate transactions with dates of closing that occur after December 31, 1986, and prior to January 1, 1991. Similarly, Treas. Reg. § 1.6045-4(a) applies to information reporting for real estate transactions with dates of closing on or after January 1, 1991.

There are no regulations under section 6045 which require [REDACTED] that act as a middleman or broker between a [REDACTED] and a sponsor to file information returns with the Service concerning payments to sponsors. Since section 6045 requires the filing of information returns only by those brokers "when required by the Secretary, . . . in accordance with such regulations as the Secretary may prescribe", it is our opinion that section 6045 does not require [REDACTED] to provide the Service with information returns concerning payments to sponsors in this case. Nor do we believe that [REDACTED] fits the definition of "middleman" under the statute.

Issue 3. Application of certain penalties.

Numerous penalties could theoretically be asserted against [REDACTED] for its failure to file the appropriate information returns pursuant to section 6041. Since we have concluded that section 6045 does not require [REDACTED] to file information returns, we will not discuss the penalties which could otherwise be applied under that section.

Congress substantially restructured the civil penalties associated with failing to file correct information returns under sections 6721 through 6724 by section 7711(a) of the Revenue Reconciliation Act of 1989 P.L. 101-239, 103 Stat. 2388 (1989) ("1989 Act"). These sections apply to returns due after 1989, including returns filed in 1990, for the 1989 tax year. For information returns due before 1990, that is, for reporting year 1988 and previous years, the old rules apply. The old rules involve the application of sections 6721 through 6724 prior to revision by the 1989 Act and section 6676 prior to its repeal by the 1989 Act. Since this is a nondocketed case and does not involve a specific tax year at this time, we will only address the prospective application of the new rules. Should you determine it is necessary, we would be pleased to consider the application of the old rules upon your request.

For any failure to file timely correct information returns, a penalty of \$50 per return failure, not to exceed \$250,000 for any calendar year, may be charged. I.R.C. § 6721(a)(1). The penalty may be reduced, however, to \$15 per return, not to exceed

\$75,000 annually, if the failure is corrected within 30 days of the required filing date of the return (with regard to extensions), or to \$30 per return, not to exceed \$150,000 annually, if the failure is corrected on or before August 1 of the year in which the required filing date occurs. I.R.C. § 6721(b). Exceptions are provided for a de minimis failure to include all of the information required to be shown on the return, if corrected on or before August 1, and the number of effected returns for the payor does not exceed the greater of 10 or 5% of the total information returns that must be filed for that year. I.R.C. §§ 6721(c) and 6724(d)(4).

For any failure to furnish a payee with a "correct payee statement", on or before the prescribed date, the penalty is \$50 for each statement failure not to exceed \$100,000 for any calendar year. I.R.C. § 6722(a). For any failure which is in intentional disregard of the filing requirements and/or requirements for providing correct payee statements, penalties are \$100 per failure or, if greater, 10% of the aggregate amount of items to be reported correctly. I.R.C. §§ 6721(e) and 6722(c). For any failure to timely comply with a specified information reporting requirement, a penalty may be imposed of \$50 per failure not to exceed \$100,000. I.R.C. § 6723. Information returns and payee statements required by section 6041 are subject to these penalties. I.R.C. §§ 6724(d)(1)(A)(i) and (d)(2)(C).

These penalties may be waived for any failures which are shown to be due to reasonable cause and not due to willful neglect. I.R.C. § 6724(a). Under Temp. Treas. Reg. § 301.6724-1T(a)(2), a penalty is waived for reasonable cause only if the filer establishes that there are either significant mitigating factors for the failure or the failure arose from events beyond the filer's control and the filer acted in a responsible manner before and after the failure occurred. Id.

One mitigating factor is that the filer was never required to file the particular type of return or furnish the particular type of statement with respect to which the failure occurred. Another mitigating factor is whether the filer has an established history of complying with the information reporting requirement with respect to which the failure occurred. In determining whether the filer has such an established history, significant consideration is given to whether the filer has incurred similar penalties in prior years and, if such penalties were incurred in prior years, the extent of the filer's success in lessening its error rate from year to year. This is not an exclusive list of mitigating factors. Temp. Treas. Reg. § 301.6724-1T(b).

The regulations also provide a non-exclusive list of events which are considered to be beyond the filer's control:

1. The unavailability of relevant business records;

2. An undue economic hardship relating to filing on magnetic media;
3. Certain actions of the Service;
4. Certain actions of an agent; and
5. Certain actions of the payee or other persons providing necessary information with respect to the return or payee statement.

Temp. Treas. Reg. § 301.6724-1T(c)(1). Temp. Treas. Reg. §§ 301.6724-1T(c)(2)-(6) further define each of the above five categories.

As mentioned above, to qualify for a reasonable cause waiver under section 6724, in addition to establishing that there were either significant mitigating factors or events beyond the filer's control, the filer must also establish that he acted in a responsible manner before and after the failure occurred. Temp. Treas. Reg. § 301.6724-1T(a)(2). Acting in a responsible manner means that a filer exercised reasonable care, which is that standard of care that a reasonably prudent person would use under the circumstances in the course of its business in determining its filing obligations and in handling account information such as account numbers and balances. Further, the filer should show that he undertook significant steps to avoid or mitigate the failure. Temp. Treas. Reg. § 301.6724-1T(a)(1). For instance, requesting extensions of time to file, attempts to prevent a failure, acting to remove an impediment or the cause of the failure once it occurred, and rectifying a failure to file promptly, if possible, once the failure is discovered. Temp. Treas. Reg. § 301.6724-1T(a)(1)(ii).

Section 7203 is a criminal statute which applies to willful failures to file returns, supply information or pay tax. That section states:

Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$25,000 (\$100,000 in the case of a corporation), or imprisoned not more than 1 year, or both, together with the costs of prosecution. . . .

We note the facts are not sufficiently developed to provide you with definite advice at this time. Therefore, we can only

provide you with a general opinion of how the above penalties may apply to [REDACTED]. Since [REDACTED] has failed to provide any of the information returns required by section 6041(a), we believe that a case exists for the imposition of the civil penalties under sections 6721 through 6723. Success would primarily depend on [REDACTED]'s ability to establish grounds for a reasonable cause waiver under section 6724(a). However, we would like to point out that the [REDACTED] and [REDACTED] number industries are relatively new. Further, there is an indication that there may be some uncertainty regarding filing requirements in this industry since you have informed us that some of the [REDACTED] subsidiaries file information returns and others do not. With this in mind, we recommend the use of discretion before imposing these penalties, based on only these facts, for years prior to the time [REDACTED] was informed by the revenue agent that it should provide information returns. Should you desire more specific information concerning the imposition of these penalties, we would be pleased to reconsider your request for advice at a future date when more facts are known.

Section 7203, is a criminal statute which carries a prohibitive fine and the possibility of imprisonment. The enforcement of this penalty would involve a criminal investigation and be subject to a "beyond a reasonable doubt" standard of proof. We believe that the imposition of this penalty requires a particularly egregious set of factual circumstances. Further, we believe the Criminal Tax Division should be consulted for their opinion before any such penalty is asserted. At this time, however, we believe any specific comment on this issue would be premature.

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